

**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

**IN RE:** ) **Chapter 11**  
 )  
**JOSEPH GRASSO,** ) **Case No. 12-11063 (MDC)**  
 )  
**Debtor.** )

**HEARING INFORMATION**

**Date: August 21, 2012**

**Time: 11:00 a.m. EDT**

**Place: Courtroom 5**

**Robert N.C. Nix Sr. Courthouse**

**900 Market Street**

**Philadelphia, PA 19107**

---

**OBJECTION TO ALLOWANCE OF CLAIM OF MARSHALL J. KATZ**

---

Comes now Madison Capital Company, LLC ("Madison"), by and through its counsel, and hereby objects to the allowance of the claim of Marshall J. Katz, Proof of Claim No. 26, filed in the amount of \$23,712,718.52. In support of its Objection, Madison would show the Court as follows:

**I. PRELIMINARY STATEMENT**

Marshall J. Katz ("Mr. Katz") filed a Proof of Claim (copy attached as an exhibit hereto) in this case in the amount of **\$23,712,718.52**. (*See* Claim No. 26.) Mr. Katz's claim is based on a state court action filed by Mr. Katz against Mr. Grasso, Saxby's Coffee Worldwide, LLC ("Saxby's Worldwide") and others (the "State Court Action") entitled *Marshall J. Katz v. Joseph Grasso, et al.*, No. 07-CH-24116, in the Circuit Court of Cook County, Illinois County Department, Chancery Division (the "State Court"). Prior to the filing of this case, the State Court entered an order of default as to liability against Mr. Grasso without a hearing when Mr. Grasso failed to "appear personally or through counsel" within twenty-one (21) days of having

been afforded an opportunity to do so following his counsel's withdrawal. *The State Court has not addressed the merits of Mr. Katz's claim or determined the amount of damages to be awarded against Mr. Grasso. The State Court has not entered any judgment against Mr. Grasso.*

While the State Court has not entered judgment against Mr. Grasso, the State Court conducted "prove-up hearings" regarding the damages to be awarded against various other defendants against which default orders were also entered. The State Court entered judgment against these other defendants in an amount just shy of \$24,000,000. Thus, Mr. Katz has filed a claim in this case for a similar amount.

The roughly \$24,000,000 judgment against the other defendants includes roughly \$6,000,000 in compensatory damages based almost entirely on Mr. Katz's self-serving and wholly unsupported testimony that Saxby's Coffee, Inc. ("Saxby's Coffee"), in which Mr. Katz claimed a 10.8% ownership interest, had a value of \$50,000,000 when Saxby's Coffee sold its assets to Saxby's Worldwide for \$600,000. Mr. Katz is not an appraiser or an expert in valuing companies and his testimony was based entirely on projections rather than Saxby's Coffee's actual operating results. In Saxby's Worldwide's bankruptcy case, this Court found Mr. Katz's valuation of Saxby's Coffee to be fatally "**flawed**" and "**of no value at all.**" Indeed, after two (2) full days of hearing, this Court disallowed Mr. Katz's claim against Saxby's Worldwide in its entirety for voting purposes concluding that Mr. Katz's 10.8% interest in Saxby's Coffee had no value and Mr. Katz had no claim. Mr. Katz then withdrew his Proof of Claim before this Court could enter a final order disallowing Mr. Katz's claim.

The remainder of the roughly \$24,000,000 judgment against the other defendants is for punitive damages. The State Court based its award of roughly **\$18,000,000 in punitive**

**damages** entirely on the conclusory allegations contained in Mr. Katz's complaint that were deemed admitted as the result of the orders of default.

Since the State Court has not entered judgment against Mr. Grasso, the order of default entered against Mr. Grasso has no *res judicata* or collateral estoppel effect. Consequently, this Court must consider Mr. Katz's claim on the merits. On the merits, Mr. Katz's claim should be disallowed in its entirety for the same reasons that this Court disallowed Mr. Katz's claim against Saxby's Worldwide for voting purposes. Even if this Court were to allow some or all of Mr. Katz's claim for roughly \$6,000,000 in compensatory damages (which it should not), this Court should certainly disallow Mr. Katz's claim for roughly \$18,000,000 in punitive damages. The allowance of punitive damages would not punish Mr. Grasso; instead, the allowance of punitive damages would punish Madison and Mr. Grasso's other creditors.

## **II. BACKGROUND**

On June 2, 2009, Mr. Katz filed his First Amended Complaint (the "State Court Complaint") in the State Court Action against Mr. Grasso, Coffee Shops International, LLC ("CSI"), Walnut Street Capital, LLC ("WSC"), Saxby's Coffee, Saxby's Worldwide, Kevin Meakim, Robert D. Carroll, and Nicholas Bayer (collectively, the "State Court Defendants"). (See Grasso Docket No. 93, Ex. A at p. 10.) The State Court Complaint alleged that (i) Saxby's Coffee's sale of its assets to Saxby's Worldwide for \$600,000 constituted a fraudulent transfer, breach of fiduciary duty and tortious interference with certain agreements between Mr. Katz and Saxby's Coffee, (ii) that Saxby's Worldwide was liable as a successor to Saxby's Coffee, (iii) that Mr. Grasso was an owner of Saxby's Worldwide, and (iv) that Mr. Grasso and the other State Court Defendants are jointly and severally liable for the damages that Mr. Katz allegedly incurred. (See State Court Complaint, Ex. A hereto)

On August 5, 2009, Saxby's Worldwide filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code in this Court. *In re Saxby's Worldwide Coffee, LLC*, Case No. 09-15898 (Bankr. E.D. Pa. 2009). On November 2, 2009, Saxby's Worldwide filed an adversary proceeding in this Court against Mr. Katz and others asking this Court to extend the automatic stay to Mr. Grasso, Mr. Meakim and Mr. Bayer and to enjoin Mr. Katz from proceeding against them in the State Court Action. *Saxby's Coffee Worldwide, LLC v. John Larson, et.al.*, Adv. Pro. 09-00340 (Bankr. E.D. Pa. 2009). On December 4, 2009, this Court preliminarily enjoined Mr. Katz from prosecuting the State Court Action against Mr. Grasso, Mr. Meakim and Mr. Bayer. The preliminary injunction expired when Saxby's Worldwide failed in its initial attempts to confirm a Chapter 11 plan. (*See Saxby's Worldwide*, Docket No. 96.)

After Saxby's Worldwide filed its adversary proceeding but before this Court entered the preliminary injunction, the State Court entered the orders of default against Mr. Grasso, Mr. Meakim and Mr. Carroll on Counts III, IV, VI and VII of the State Court Complaint. (*See Grasso* Docket No. 93, Ex. A at pp. 2 and 11.) The State Court's Memorandum Opinion expressly states that orders of default were entered against Mr. Grasso, Mr. Meakim and Mr. Carroll due to their "failure to appear personally or through counsel" within the time allowed by the State Court. (*See State Court Memorandum Opinion*, Grasso Docket No. 93, Ex. A, at pp. 2 and 10.) The State Court did not find or imply that the order of default against Mr. Grasso was entered due to Mr. Grasso's misconduct or failure to obey orders. (*Id.*)

On December 4, 2009, Mr. Katz filed a Proof of Claim in *Saxby's Worldwide* in the amount of ***\$14,378,291.36, roughly \$10,000,000 less than the amount now claimed.*** (*See Saxby's Worldwide*, Claim No. 27.) Mr. Katz attached a copy of the State Court Complaint to the Proof of Claim. On January 26, 2010, Saxby's Worldwide objected to the allowance of Mr.

Katz's claim. (*See Saxby's Worldwide*, Docket No. 158.) This Court permitted extensive discovery on the objection and conducted a two-day trial regarding the allowance of Mr. Katz's claim for voting purposes under Rule 3018(a) of the Federal Rules of Bankruptcy Procedure. On August 20, 2010, this Court disallowed Mr. Katz's claim in its entirety for voting purposes. (*See Ex. B* hereto, *Saxby's Worldwide*, Docket No. 412.) In so doing, this Court found Mr. Katz's \$50,000,000 valuation of Saxby's Coffee to be fatally "**flawed**" and "**of no value at all.**" (*See Ex. B* hereto, at pp. 25-26, *Saxby's Worldwide*, Docket No. 412.) Mr. Katz later withdrew his Proof of Claim in *Saxby's Worldwide* to avoid the entry of a final judgment disallowing his claim and the collateral estoppel effect of such final judgment in the State Court Action. (*See Saxby's Worldwide*, Docket No. 520.)

On November 3, 2010, the State Court conducted a "prove-up hearing" in the State Court Action with respect to damages against Saxby's Coffee, WSC and Mr. Carroll. The State Court entered judgment against these State Court Defendants in the amount of \$23,887,032.63, which was later adjusted to \$23,811,358.52. (*See State Court Final Judgment Order*, Grasso Docket No. 93, Ex. A at p. 2.) The \$23,811,358.52 judgment is comprised of compensatory damages in the amount of \$5,896,076.52 **and punitive damages in the amount of \$17,915,282.00.** (*See State Court Memorandum Opinion*, Grasso Docket No. 93, Ex. A at pp. 10-11.) Incredibly, the compensatory damages awarded includes \$5,400,000 in compensatory damages based entirely on Mr. Katz's self-serving and wholly unsupported testimony that Saxby's Coffee was worth \$50,000,000 at the time it sold its assets to Saxby's Worldwide, ***testimony which this Court had previously found to be "flawed" and "of no value at all."***

Even more incredibly, the State Court's award of almost \$18,000,000 against Saxby's Coffee, WSC and Mr. Carroll was not based on any evidence at all. Instead, the State Court

concluded that, as the result of the orders of default, the State Court Defendants had admitted the allegations contain in Paragraphs 69, 70, 82 and 83 of the State Court Complaint and that these allegations alone were sufficient to justify the imposition of almost \$18,000,000 in punitive damages. Paragraphs 69, 70, 82 and 83 of the State Court Complaint allege that Saxby's Coffee and the other State Court Defendants transferred the assets of Saxby's Coffee, Inc. without receiving reasonably equivalent value or with the intent to defraud Mr. Katz. (*See* State Court Complaint, Ex. A hereto, ¶¶ 69, 70, 82 and 83.) While these paragraphs contain conclusory allegations that State Court Defendants acted intentionally, willfully and maliciously, these paragraphs do not contain a single well-pleaded fact to support these conclusory allegations. *Id.*

Once this Court's preliminary injunction expired, the State Court scheduled a "prove-up hearing" with respect to Mr. Katz's damage claim against Mr. Grasso, Mr. Bayer and Mr. Meakim. The State Court conducted the "prove-up hearing" with respect to Mr. Katz's damages against Mr. Meakim. Based on the evidence presented at the prior "prove-up hearing," the State Court entered judgment against Mr. Meakim in the amount of \$23,712,718.52, which is comprised of \$5,928,180.73 in compensatory damages and \$17,784,538.89 in punitive damages. (*See* Grasso Docket No. 93, Ex. A at p. 6.) The State Court's decision simply adopted the reasoning from its November 3, 2010 Memorandum Opinion. (*See* State Court Final Judgment Order, Grasso Docket No. 93, Ex. A.) Mr. Grasso and Mr. Bayer filed bankruptcy staying the prosecution of the State Court Action against Mr. Grasso and Mr. Bayer.

### **III. ARGUMENT**

The State Court's entry of default as to liability against Mr. Grasso has no *res judicata* or collateral estoppel effect and, therefore, this Court must consider Mr. Katz's claim on its merits. The State Court has not entered a final judgment against Mr. Grasso, and the order of default

entered against Mr. Grasso has no *res judicata* or collateral estoppel effect. In deciding whether the doctrines *res judicata* and collateral estoppel apply, federal courts look to state law to decide what effect to give state-court judgments. *See, e.g., Turner v. Crawford Square Apartments III, L.P.*, 449 F.3d 542, 548 (3d Cir. 2006). ***Under Illinois law, only final orders are entitled to res judicata or collateral estoppel effect.*** *See, e.g., People v. Gill*, 379 Ill. App. 3d 1000, 1012, 886 N.E.2d 1043, 1053 (2008) ("*res judicata* also requires a final judgment on the merits"); *In re Marriage of Tutor*, 2011 Ill. App. 2d 100187, 956 N.E.2d 588, 593 (2011) (same); *People v. Rodriguez*, 402 Ill. App. 3d 932, 941, 932 N.E.2d 113, 121 (2010) (collateral estoppel requires final judgment on the merits); *Ford Motor Credit Co. v. Cornfield*, 395 Ill. App. 3d 896, 910, 918 N.E.2d 1140, 1153 (2009) (same).

Because the State Court has not yet determined the amount of damages to be awarded against Mr. Grasso, the State Court's order of default is not a final judgment under Illinois law. "A judgment is deemed final, for purposes of *res judicata*, if it terminates litigation on the merits so that the only issue remaining is proceeding with its execution." *SDS Partners, Inc. v. Cramer*, 305 Ill. App. 3d 893, 896, 713 N.E.2d 239, 240 (1999). "A default order as to liability only does not constitute a final order." *Miura v. Famous Cab Co.*, 107 Ill. App. 3d 803, 806, 438 N.E.2d 530, 533 (1982); *see also Alderson v. Berol Products Div., Berol Corp.*, 38 Ill. App. 3d 139, 141, 142, 347 N.E.2d 213, 214 (1976) (judgment on issue of liability only with damages yet to be ascertained is not final).

On the merits, Mr. Katz's claim should be disallowed in its entirety for the same reasons that this Court disallowed Mr. Katz's claim against Saxby's Worldwide for voting purposes. In disallowing Mr. Katz's claim, this Court found that the sale complained of in the State Court Complaint was not fraudulent or tortious and that Mr. Katz did not suffer any damages. (*See Ex.*

B hereto, *Saxby's Worldwide*, Docket No. 412.) Virtually all the compensatory damages claimed by Mr. Katz were premised on Mr. Katz's self-serving and wholly unsupported assertion that Saxby's Coffee was worth \$50,000,000 at the time it sold its assets to Saxby's Worldwide for \$600,000 and that his alleged 10.8% interest therein was worth \$5,400,000. This Court expressly rejected Mr. Katz's valuation:

Third, to the extent that Marshall Katz's dissatisfaction with this transaction is based on his view that the \$600,000 consideration paid by Grasso and Meakim was grossly inadequate, and relying for that belief on his testimony that SCI's value in June and July of 2007 was \$50 million. I am totally unpersuaded by the evidence that he offered in support of that valuation. I find Marshall Katz's valuation flawed in that it was based on assumptions regarding future cash flows set out in a business plan whose purpose was to solicit investment, not based on any reliable report regarding the financial position of the company. The assumptions had no historic basis in company performance. Simply put, the projections were wildly over-optimistic, because they were based on income derived from contracts not yet in existence and whose development required an infusion of capital that was not made prior to the asset transaction. As a finder of fact -- as the finder of fact it is within my providence to decide the weight, if any, to be given Marshall Katz's valuation testimony. Here I find that testimony to be of no value at all. I reject it in its entirety. As a consequence Marshall Katz has offered no valuation evidence that would support a finding that the consideration for sale of SCI's assets was not reasonably equivalent value.

(See Ex. B hereto, at pp. 25-26, *Saxby's Worldwide*, Docket No. 412).

Even if this Court were to allow some or all of Mr. Katz's claim for roughly \$6,000,000 in compensatory damages (which it should not), this Court should certainly disallow Mr. Katz's claim for roughly \$18,000,000 in punitive damages because, rather than punishing Mr. Grasso, the allowance of punitive damages would punish Madison and Mr. Grasso's other creditors. Bankruptcy courts have the equitable power to disallow punitive damages claims and routinely do so. See, e.g., *In re A.H. Robins Co., Inc.*, 89 B.R. 555 (E.D. Va. 1988); *In re FF Holdings*



*Corp. & Farm Fresh Inc.*, No. 98-37/38-JFF, 1998 U.S. Dist. LEXIS 10741 (D. Del. Feb. 17, 1998). The disallowance of punitive damage claims in bankruptcy cases stems from the penal nature of punitive damages. The traditional state law goal of punishing the debtor is simply not attainable in bankruptcy cases. Allowing a claim for punitive damages in bankruptcy "would serve more to punish unsecured creditors than it would to punish the debtor." *In re Hillsborough Holdings Corp.*, 218 B.R. 617, 620 (Bankr. M.D. Fla. 1991). When the debtor's creditors have not been paid in full, permitting distribution for punitive damages only harms the other unsecured creditors and fails to serve as a punishment for the debtor. *See Olympia Equipment Leasing Co. v. Western Union Telegraph Co.*, 786 F.2d 794, 797 (7th Cir. 1986). "[T]o allow a claim for punitive damages in these circumstances would make innocent creditors bear the burden of the debtor's wrongdoing." *Id.* Allowing Mr. Katz's claim for almost \$18,000,000 in punitive damages would require Madison and Mr. Grasso's other creditors to bear the burden of Mr. Grasso's alleged wrongdoing.

#### **IV. CONCLUSION**

For the reasons set forth above, Madison prays that this Court disallow Mr. Katz's claim in its entirety and grant such further relief as this Court deems just and proper.

DATED: July 16, 2012.

Respectfully submitted,

/s/ Roger G. Jones

Roger G. Jones (Tenn. B.P.R. No. 20877)

Admitted *Pro Hac Vice*

BRADLEY ARANT BOULT CUMMINGS LLP

1600 Division St., Ste. 700

Nashville, TN 37203

(615) 252-2323

RJones@babco.com

/s/ Jeffery T. Grossman

Jeffrey T. Grossman, Esquire

GROSSMAN LAW FIRM, P.C.

1333 Race Street

Philadelphia, PA 19107

(215) 231-9936

jgrossman@grossmanfirm.com

*Attorneys for Madison Capital Company, LLC*

**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the foregoing was served on July 16, 2012, on all parties consenting to service through the Court's CM/ECF system and by U.S. Mail, postage pre-paid, to the following parties:

Dimitri L. Karapelou  
Law Offices of Dimitri L. Karapelou, LLC  
1600 Market Street, 25<sup>th</sup> Floor  
Philadelphia, PA 19103

Paul J. Winterhalter, Esquire  
Law Office of Paul J. Winterhalter, P.C.  
1717 Arch Street, Suite 4110  
Philadelphia, PA 19103  
pwinterhalter@pjw-law.com

Dave P. Adams  
United States Trustee  
833 Chestnut Street, Suite 500  
Philadelphia, PA 19107  
d.p.adams@usdoj.gov

Kevin P. Callahan  
United States Trustee  
Department of Justice  
833 Chestnut Street, Suite 500  
Philadelphia, PA 19107  
k.p.callahan@usdoj.gov

Jeffrey C. Venzie, Esquire  
Venzie, Phillips, & Warshawer  
2030 Chancellor Avenue  
Philadelphia, PA 19103  
jvenzie@venzie.com

William J. Levant, Esquire  
Kaplin Stewart, Meloff, Reiter & Stein,  
P.C.  
910 Harvest Drive  
P.O. Box 3037  
Blue Bell, PA 19422  
wlevant@kaplaw.com

Bonnie Golub, Esquire  
Weir & Partners, LLP  
The Widner Building  
1339 Chestnut Street, Suite 500  
Philadelphia, PA 19107  
bgolub@weirpartners.com

Gretchen Santamour, Esquire  
Steven J. White, Esquire  
Stradley, Ronon, Stevens, & Young, LLP  
2600 One Commerce Square  
Philadelphia, PA 19103  
gsantamour@stradley.com  
swhite@stradley.com

Holly E. Smith, Esquire  
Ciardi, Ciardi & Astin, P.C.  
One Commerce Square  
2005 Market Street, Suite 1930  
Philadelphia, PA 19103  
hsmith@ciardilaw.com

Linda L. Kelly, Attorney General  
Christopher R. Momjian, Senior Deputy  
Attorney General  
Office of the Attorney General  
21 South 12th Street, 3rd Floor  
Philadelphia, PA 19107  
crmomjian@attorneygeneral.gov

Gary M. Schildhorn, Esquire  
Brya M. Keilson, Esquire  
Eckert, Seamans, Cherin, & Mellot, LLC  
Two Liberty Place  
50 South 16th Street, 21st Floor  
Philadelphia, PA 19102  
gschildhorn@eckertseamans.com  
bkeilson@eckertseamans.com

Marisa J. Cohen, Esquire  
Margaret Gairo, Esquire  
Kevin T. McQuail, Esquire  
McCabe, Weisberg, and Conway, P.C.  
123 South Broad Street  
Philadelphia, PA 19109  
mgairo@mwc-law.com

Michael Gigliotti, Esquire  
Kashkashian, Franklin, & Associates  
10 Canal Street, Suite 204  
Bristol, PA 19007  
kashlaw@aol.com  
Ronald S. Gellert, Esquire  
Eckert, Seamans, Cherin, & Mellot, LLC  
Two Liberty Place  
50 South 16th Street, 21st Floor  
Philadelphia, PA 19102  
rgellert@eckertseamans.com

GE Capital Retail Bank  
c/o Recovery Management Systems  
Corporation  
25 Southeast 2nd Avenue, Suite 1120  
Miami, FL 33131-1605  
Attention: Ramesh Singh  
claims@recoverycorp.com

Aaron J. Margolis, Esquire  
Duane Morris, LLP  
30 South 17th Street  
Philadelphia, PA 19107  
amargolis@duanemorris.com

Brian H. Smith, Esquire  
Christopher McDonald, Esquire  
Lamm Rubenstone, LLC  
3600 Horizon Boulevard, Suite 150  
Trevose, PA 19053  
bsmith@lammrubenstone.com  
cmcdonald@lammrubenstone.com

Brian M. Kile, Esquire  
Grenen & Birsic, P.C.  
One Gateway Center, 9th Floor  
Pittsburg, PA 15222  
bkile@grenenbirsic.com

Edward J. Hayes, Esquire  
Fox Rothschild, LLP  
200 Market Street, 20th Floor  
Philadelphia, PA 19103  
EHayes@foxrothchild.com  
Adam A. Lewis, Esquire  
Morrison & Foster, LLP  
425 Market Street  
San Francisco, CA 94105  
alewis@mofo.com

James Greenberg, Esquire  
Duane Morris, LLP  
1940 Route 70 East, Suite 200  
Cherry Hill, NJ 08003  
jgreenberg@duanemorris.com

James K. Haney, Esquire  
Wong Fleming, P. C.  
1515 Market Street, Suite 820  
Philadelphia, PA 19102  
jhaney@wongfleming.com

Joseph McMahon, Jr.  
Daniel K. Astin, Esquire  
John D. McLaughlin, Jr.  
Ciardi, Ciardi, & Astin,  
919 North Market Street, Suite 700  
Wilmington, DE 19801  
jmcMahon@ciardilaw.com

Stephen J. Labroli, Esquire  
Leonard, Sciolla, Hutchinson, Leonard, &  
Tinari, LLP  
Two Penn Center  
1500 John F. Kennedy Boulevard, Suite  
1910  
Philadelphia, PA 19102  
slabroli@leonardsciolla.com

Issac M. Gabriel, Esquire  
Quarles & Brady, LLP  
One Renaissance Square  
Two North Central Avenue  
Phoenix, AZ 85004  
isaac.gabriel@quarles.com

/s/ Roger G. Jones  
Roger G. Jones